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# Securities Law — Insider Liability Under Section 16 (b) of the Securities Exchange Act of 1934 — Whiting v. Dow Chemical Co

Ann E. Weigel

the work was originally created as a work for hire and that the putative employer "could have exercised the requisite power to control or supervise" the author-employee.[134] If a renewal proprietor asserts that the copyright was renewable under the corporate-body provision, he faces three tasks. He must establish that the work was not authored by one identifiable person. He must show that the persons who composed the work were related to the corporation which obtained original copyright, but related in some way other than as employees or assignors. Furthermore, he must show that their contributions to the work are merged and "incapable of separate identification." These requirements would seem to foreclose the utilization of the corporate-body provision as a basis for upholding a renewal for all but an extremely limited type of work.

ANNE ELIZABETH ROGERS

**Securities Law—Insider Liability Under Section 16(b) of The Securities Exchange Act of 1934—*Whiting v. Dow Chemical Co.*[1]**—In September and October of 1973, Helen Dow Whiting sold 29,770 shares of Dow Chemical Company (Dow), which she had acquired by gift and inheritance.[2] In December of 1973, her husband Macauley Whiting, a director of Dow, exercised his executive stock option and purchased 21,420 shares of Dow.[3] To finance his purchase, Mr. Whiting borrowed some of the funds which Mrs. Whiting had received from her earlier sales.[4] The sales and purchase were made pursuant to a joint long-term investment plan which the Whitings had devised with their financial adviser.[5] Although the Whitings maintained separate investment accounts,[6] they filed a joint income tax return and combined their individual funds to meet the family's living expenses.[7] Mr. Whiting contributed nearly his entire salary towards those expenses.[8] Mrs. Whiting contributed an even larger sum, primarily derived from dividends and capital gains on her Dow holdings.[9]

When Dow informed Mr. Whiting of its intention to recover the profits realized as a result of matching Mrs. Whiting's sales with Mr.

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[134] 522 F.2d at 744.

[1] 523 F.2d 680 (2d Cir. 1975).

[2] *Id.* at 682. At the time of her sales, Mrs. Whiting owned less than 10% of the outstanding shares of Dow common. Whiting v. Dow Chem. Co., 386 F. Supp. 1130,1131 (S.D.N.Y. 1974).

[3] 523 F.2d at 682.

[4] *Id.*

[5] *Id.* at 684.

[6] *Id.* at 683.

[7] *Id.* at 682.

[8] *Id.*

[9] *Id.*

Whiting's purchase,[10] he sought a declaratory judgment in federal district court that he was not liable under section 16(b) of the Securities Exchange Act of 1934[11] (the Act) for the alleged short-swing[12] profit.[13] Dow counterclaimed in this action for the profit.[14] The district court concluded that, despite the fact that Mr. Whiting was not the owner of the shares sold by Mrs. Whiting, he was nonetheless liable under section 16(b).[15] The court's decision was based on the premise that since the term "profit realized by him"[16] in section 16(b) was susceptible of several interpretations, it should be construed broadly in order to effectuate the congressional purpose of eliminating short-swing trading based on inside information.[17] This policy, the court reasoned, demanded attribution of a spouse's transactions to an insider[18] if the family situation indicated that the spouse's transactions could be influenced by insider information.[19] The Whiting's joint financial planning and contributions to the family's living expenses indicated to the court not only that the Whitings had a common interest in mutual prosperity but also that they communicated easily on mat-

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[10] Whiting v. Dow Chem. Co., 386 F. Supp. 1130, 1131 n.1 (S.D.N.Y. 1974).

[11] 15 U.S.C. § 78p(b) (1970). Section 16(b) provides:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

*Id.*

[12] Short-swing profits are gains made on a purchase-sale or sale-purchase within a period of six months. *See id.*

[13] 523 F.2d at 682.

[14] *Id.*

[15] Whiting v. Dow Chem. Co., 386 F. Supp. 1130, 1132, 1138 (S.D.N.Y. 1974).

[16] 15 U.S.C. § 78p(b) (1970). The text of § 16(b) is quoted at note 11 *supra.*

[17] 386 F. Supp. at 1136.

[18] Section 16(a) of the Act, 15 U.S.C. § 78p(a) (1970), defines an insider as a person owning, directly or indirectly, more than 10% of any equity security which is registered pursuant to § 12 of the Act, 15 U.S.C. § 78*l* (1970), or as an officer or director of the company. The text of § 16(a) is quoted at note 46 *infra.*

[19] *See* 386 F. Supp. at 1137.

ters related to that prosperity.[20] This type of relationship, the court concluded, was susceptible to insider abuse.[21] Thus, the court attributed Mrs. Whiting's sales to Mr. Whiting and held him accountable for the profit realized.[22]

On appeal, the Court of Appeals for the Second Circuit affirmed and HELD: Although a husband does not exercise "exclusive" control over his wife's investments, if he enjoys the benefits of ownership he is the "beneficial owner" of his wife's securities and thus is liable for the profit realized as a result of matching her sales with his purchase within a six month period.[23] The court reasoned that if the rewards of a spouse's ownership—income and profit, as well as power of disposal by gift or at death—are used for the joint benefit of the spouses, the possibility exists that inside information will be abused.[24] The Whitings' financial relationship suggested to the court that Mr. Whiting shared in the rewards of his wife's ownership. Not only did they jointly contribute to the family's living expenses, but they also engaged in joint financial planning which had included the questioned sales and purchase.[25] If liability was not imposed under these circumstances, the court stated, the door would be open to the very abuse of inside information which Congress had sought to prevent.[26]

The *Whiting* decision is typical of the traditional pragmatic approach to section 16(b).[27] This note will examine the *Whiting* court's application of that approach to the spousal attribution issue. Although the Supreme Court has never directly addressed the attribution issue, it has indicated, particularly in its post-*Whiting* decision, *Foremost-McKesson, Inc. v. Provident Securities Co.*,[28] a framework for construing 16(b) definitional terms such as "beneficial owner." The viability of the *Whiting* decision will be analyzed in light of the Supreme Court's analytical scheme, with particular emphasis on the legislative history of the term "beneficial owner." It will ultimately be submitted that although the *Whiting* court's interpretation of that term may be consistent with section 16(b)'s remedial purpose of preventing the unfair use of inside information, it is contrary to the legislative history underlying the term "beneficial owner;" thus, the *Whiting* court incorrectly broadened the scope of section 16(b) by holding a director liable for the profit realized on a matching of his purchase with his spouse's sales.

Section 16(b) of the Securities Exchange Act of 1934 prohibits short-swing sales and purchases by corporate insiders.[29] An insider is

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[20] *Id.* at 1132, 1137.
[21] *Id.* at 1138.
[22] *Id.*
[23] 523 F.2d at 688-89.
[24] *Id.* at 688.
[25] *Id.*
[26] *Id.* at 689.
[27] See text at notes 31-52 *infra*.
[28] 423 U.S. 232 (1976).
[29] *See* 15 U.S.C. § 78p(b) (1970). The text of § 16(b) is quoted at note 11 *supra*.

defined as either a director or officer of a corporation or a "beneficial owner" of at least 10 percent of a registered equity security of a corporation.[30] In interpreting this section, the courts traditionally have followed two approaches.[31] The early cases[32] adopted an objective, mechanical approach.[33] Under this approach, the definitional limits of the section were construed broadly in light of the section's remedial purpose, irrespective of whether Congress intended to prevent the particular type of transaction in question.[34] If a transaction fell within the broad definitional limits, liability attached.[35]

In response to the harshness and unfairness of the objective approach,[36] the courts developed what has been labeled a subjective or pragmatic approach.[37] A court which adopts this approach analyzes a transaction in two distinct steps.[38] The first step is similar to the objective approach inasmuch as the court determines whether the trans-

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[30] 15 U.S.C. § 78p(a) (1970). The text of § 16(a) is quoted at note 46 *infra*.

[31] Bateman, *The Pragmatic Interpretation of Section 16(b) and the Need for Clarification*, 45 ST. JOHN'S L. REV. 772 (1971). For discussion of the two approaches see Hazen, *The New Pragmatism Under Section 16(b) of the Securities Exchange Act*, 54 N.C.L. REV. 1 (1975); Wentz, *Refining a Crude Rule: The Pragmatic Approach to Section 16(b) of the Securities Exchange Act of 1934*, 70 NW. U.L. REV. 221 (1975).

[32] *See, e.g.*, Gratz v. Claughton, 187 F.2d 46 (2d Cir. 1951); Park & Tilford, Inc. v. Schulte, 160 F.2d 984 (2d Cir. 1947); Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir. 1943).

[33] The objective approach apparently arose out of a statement of Mr. Thomas Corcoran, a drafter of the Act, that the section was a "crude rule of thumb:"

> You hold the director, irrespective of any intention or expectation to sell the security within 6 months after, because it will be absolutely impossible to prove the existence of such intention or expectation, and you have to have this crude rule of thumb, because you cannot undertake the burden of having to prove that the director intended, at the time he bought, to get out on a short swing.

*Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess., pt. 15, at 6557 (1934). Arguably, "crude rule of thumb" can be construed to mean that § 16(b) is to be interpreted broadly, as the objective approach does, without regard to the harshness which might ensue. Wentz, *supra* note 31, at 231 n.32. Alternatively, because of the context in which the statement was made, "crude rule of thumb" may merely have meant that liability is to be imposed regardless of the insider's intent. *Id.* Thus, it is suggested that the phrase does not rule out a pragmatic approach inasmuch as a pragmatic approach does not examine the insider's actual intent. *Id. See also* Bateman, *supra* note 31, at 776 & n.13.

[34] In Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir. 1943), the court stated:

> The statute is broadly remedial. . . . We must suppose that the statute was intended to be thorough-going, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty.

*Id.* at 239. *See* Wentz, *supra* note 31, at 227-28.

[35] Wentz, *supra* note 31, at 227.

[36] *Id.* at 228.

[37] *See, e.g.*, Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582, 594 n.26 (1973).

[38] Wentz, *supra* note 31, at 225.

action is within the section's general definitional boundaries.[39] If the transaction is within those boundaries, the court then determines whether the transaction is the type which might lend itself to an abuse of inside information.[40] Liability will attach only if the response to both inquiries is affirmative.[41]

In *Whiting*, the Second Circuit appears to have adopted the pragmatic approach. The court complied with the first step of the approach when it initially determined that Mrs. Whiting's sales fell within the section's general definitional boundaries.[42] Noting that section 16 does not expressly define an insider to include the spouse of an insider,[43] the court sought to determine whether the term "beneficial owner" in section 16(b) of the Act required spousal attribution even though the director did not exercise "exclusive" control over his spouse's transactions.[44] For guidance, the court looked to section 16(a),[45] which requires an insider to provide the Securities and Exchange Commission (the SEC) with an up-to-date listing of the company's securities "of which he is the beneficial owner."[46] The court noted that "beneficial owner," as used in section 16(a), had been interpreted in a 1966 SEC release[47] to require an insider to include in

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[39] *Id.*

[40] *Id.*

[41] *See, e.g.*, Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973); Petteys v. Butler, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967); Blau v. Max Factor & Co., 342 F.2d 304 (9th Cir. 1965); Adler v. Klawans, 267 F.2d 840 (2d Cir. 1959); Ferraiolo v. Newman, 259 F.2d 342 (6th Cir. 1958).

[42] 523 F.2d at 688.

[43] *Id.* at 685.

[44] *Id.*

[45] *Id.*

[46] 15 U.S.C. § 78p(a) (1970). The subsection provides:

> Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of an equity security (other than an exempted security) which is registered pursuant to section 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78*l*(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

*Id.*

[47] 31 Fed. Reg. 1005 (1966). The release provides:

> Generally a person is regarded as the beneficial owner of securities held in the name of his or her spouse and their minor children. Absent special circumstances such relationship ordinarily results in such person obtaining benefits substantially equivalent to ownership, e.g., application of

his report to the SEC securities held in the name of a spouse and minor children.[48] Absent special circumstances which show that a spouse does not receive "benefits substantially equivalent to ownership," the release creates a presumption that such securities are beneficially owned by the insider.[49] Reading section 16(b) broadly in light of its remedial purpose, the court infused the term "beneficial owner" in that section with the spousal attribution concept which the SEC had applied to the term in section 16(a).[50] This broad construction of the term brought the Whitings' transactions within section 16(b)'s general definitional boundaries.

Turning then from the first step of the pragmatic approach to the second, the court determined that the Whitings' relationship did create the possibility of an abuse of inside information.[51] The court reasoned that their relationship indicated that Mr. Whiting shared in the rewards of his spouse's ownership.[52] Thus, both steps of the pragmatic approach were satisfied and Mr. Whiting was held liable for the profit realized as a result of matching his purchase with his wife's sales.

Other courts have also attributed a spouse's transactions to a director, but have done so without extensive analysis. In *Bershad v. McDonough*,[53] for example, the Seventh Circuit imputed a spouse's

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> the income derived from such securities to maintain a common home, to meet expenses which such person otherwise would meet from other sources, or the ability to exercise a controlling influence over the purchase, sale, or voting of such securities. Accordingly, a person ordinarily should include in his reports filed pursuant to Section 16(a) securities held in the name of a spouse or minor children as being beneficially owned by him.
>
> A person also may be regarded as the beneficial owner of securities held in the name of another person, if by reason of any contract, understanding, relationship, agreement, or other arrangement, he obtains therefrom benefits substantially equivalent to those of ownership. Accordingly, where such benefits are present such securities should be reported as being beneficially owned by the reporting person. Moreover, the fact that the person is a relative or relative of a spouse and sharing the same home as the reporting person may in itself indicate that the reporting person would obtain benefits substantially equivalent to those of ownership from securities held in the name of such relative. Thus, absent countervailing facts, it is expected that securities held by relatives who share the same home as the reporting person will be reported as being beneficially owned by such person.
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> A person also is regarded as the beneficial owner of securities held in the name of a spouse, minor children or other person, even though he does not obtain therefrom the aforementioned benefits of ownership, if he can vest or revest title in himself at once, or at some future time.

*Id.* at 1006 (footnote omitted).

[48] *Id.*

[49] *See id.*

[50] *See* 523 F.2d at 688.

[51] *Id.* at 688-89.

[52] *Id.* at 688.

[53] 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971). *See also* B.T. Babbitt, Inc. v. Lachner, 332 F.2d 255, 257 (2d Cir. 1964) (parties stipulated to attribution).

purchases and sales to a director without discussion of the attribution issue.[54] In *Blau v. Potter*,[55] *Schur v. Salzman*[56] and *Marquette Cement Manufacturing Co. v. Andreas*,[57] the district courts treated the issue of attribution as a question of fact. Using the criteria set forth in the SEC 16(a) release, the *Schur* court found that there were no special circumstances which indicated that the director was not the beneficial owner of his wife's shares.[58] In *Blau*, on the other hand, the court did not attribute the wife's purchase to the husband because her assets were separate, none of her funds were used to defray her own or family living expenses, and her spouse was unaware of her trading activity.[59] The *Marquette* court likewise did not attribute, inasmuch as the director and his wife were divorced.[60] Thus, the *Whiting* court is not alone in considering the attribution of a spouse's transactions to an insider.

While the *Whiting* court's result is consistent with decisions reached by other federal courts, the initial broad reading of the term "beneficial owner" is inconsistent with the manner in which the Supreme Court has construed 16(b)'s definitional terms. Prior to the *Whiting* decision, the Supreme Court had considered three 16(b) cases. These cases did not, however, provide clear guidelines for construing 16(b). In the first and the last of these three cases, *Blau v. Lehman*[61] and *Kern County Land Co. v. Occidental Petroleum Corp.*[62] respectively, the Court appeared to adopt a mode of analysis similar to the pragmatic approach.[63] On the other hand, in the intervening case of *Reliance Electric Co. v. Emerson Electric Co.*,[64] the Court adopted essentially an objective approach.[65] In light of this apparent lack of consistency, it is not surprising that the *Whiting* court chose to follow the pragmatic approach, seemingly subscribed to in *Kern County*.

When these three cases are viewed in conjunction with the Court's post-*Whiting* decision, *Foremost-McKesson, Inc. v. Provident Securities Co.*,[66] it appears, however, that the Court has adopted a consistent approach. Moreover, this approach does not comport with the traditional pragmatic approach utilized by the *Whiting* court. Like the pragmatic approach, the Court's approach has two steps. The second step of the Court's approach and the second step of the pragmatic

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[54] 428 F.2d at 695.

[55] [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶94,115, at 94,477 (S.D.N.Y. 1973).

[56] 365 F. Supp. 725, 732 (S.D.N.Y. 1973).

[57] 239 F. Supp. 962, 967 (S.D.N.Y. 1965).

[58] 365 F. Supp. at 732.

[59] [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶94,115, at 94,477.

[60] 239 F. Supp. at 967.

[61] 368 U.S. 403 (1962).

[62] 411 U.S. 582 (1973).

[63] *See* Wentz, *supra* note 31, at 231, 257.

[64] 404 U.S. 418 (1972).

[65] Wentz, *supra* note 31, at 231.

[66] 423 U.S. 232 (1976).

approach are identical inasmuch as they both involve an inquiry into the possibility of insider abuse.[67] However, the Court's first step departs significantly from the first step of the pragmatic approach. Rather than initially interpreting 16(b)'s definitional terms in light of the section's remedial purpose, the Court has chosen to construe the terms solely in light of their legislative history.[68] If the legislative history reveals that the term is susceptible to only one construction, an inquiry into the possibility of abuse is inappropriate.[69] If, on the other hand, the term is capable of more than one construction, the Court will resolve the ambiguity in favor of a construction which effectuates the section's remedial purpose.[70]

In the first case, *Blau v. Lehman,*[71] the Court was confronted with the question of whether a partnership could be a "director" for 16(b) purposes. One of the partners of Lehman Brothers, a New York investment firm, had become a director of Tide Water Associated Oil Company. Because the evidence indicated that the partner had not performed his duties as a director on behalf of the partnership, the Court refused to treat Lehman Brothers as a director within the meaning of section 16(b).[72] In reaching this conclusion, the Court noted that under sections 3(a)(7)[73] and 3(a)(9)[74] of the Act, a partnership can be considered a director if it is demonstrated that the partnership, and not the partner, actually functioned as the director.[75] Moreover, in response to the contention that a partnership should be included because it might be "tipped off" by a partner who was a director, the Court stated that Congress had rejected an expansion of 16(b) to include tippees.[76] The Court pointed out that a provision in early drafts of 16(b) which would have held tippees liable had been

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[67] *See Kern,* 411 U.S. 582, 596-604 (1973).

[68] *See Provident,* 423 U.S. 232, 244 (1976).

[69] *See Reliance,* 404 U.S. 418, 424 (1972).

[70] *See Kern,* 411 U.S. 582, 593-95 (1973).

[71] 368 U.S. 403 (1962).

[72] *Id.* at 410.

[73] 15 U.S.C. § 78c(a)(7) (1970). The section provides that "[t]he term 'director' means any director of a corporation or any person performing similar functions with respect to any organization . . . ." *Id.*

[74] *Id.* § 78c(a)(9). This section provides that "[t]he term 'person' means an individual, a corporation, a partnership . . . ." *Id.*

[75] 386 U.S. at 409-10. Although the Court did not mention it, § 20(a) of the Act, 15 U.S.C. § 78t(a) (1970), also appears to provide a basis for holding a partnership liable under 16(b). This provision declares that any person directly or indirectly controlling an individual subject to the Act is jointly and severally liable with the controlled person, unless he can demonstrate he acted in good faith and did not directly or indirectly induce the unlawful acts. *Id.* For a discussion of liability under this section, see SEC v. Management Dynamics, Inc., 515 F.2d 801, 812 (2d Cir. 1975); Comment, *The Burden of Control: Derivative Liability Under Section 20(a) of the Securities Exchange Act of 1934,* 48 N.Y.U.L. REV. 1019 (1973).

[76] 368 U.S. at 411-12. A "tippee" is an individual to whom material, nonpublic corporate information has been communicated. *See* 2 A. BROMBERG, SECURITIES LAW: FRAUD §§ 7.5(1), (2), at 190.7 (1975).

eliminated from the final legislation.[77] Thus, the Court seemed willing to initially construe 16(b)'s definitional terms in light of the express definition provided by Congress in other sections of the Act. Absent evidence of control, however, the Court was unwilling to further construe the meaning of director to include partnerships, despite the fact that the congressional purpose of preventing abuse of insider information would be effectuated by such an expansion.

In the next case, *Reliance Electric Co. v. Emerson Electric Co.*,[78] the Court construed the Act's requirement that an individual be a 10 percent owner "at the time of . . . sale . . ." and again rejected an initial construction based on the section's remedial purpose.[79] Faced with the question of whether a shareholder owning 13.2 percent of the outstanding shares could sell down to 9.96 percent and then sell the remainder without liability,[80] the Court held that the second sale was exempt.[81] The Court strictly reasoned that the section's literal language required that an individual be a 10 percent owner at the time of his sale. Because the defendant owned only 9.96 percent at the time of his second sale, no liability attached under section 16(b).[82] The Court also rejected the argument that the section's purpose would be undermined if this language was not construed to provide an inquiry into whether the two sales were part of a single plan of disposal. The Court stated that such an inquiry would be contrary to Congress' desire to impose liability without a subjective consideration of the insider's intent.[83] Thus, as in *Blau,* the Court refused to base the initial construction of 16(b)'s terms solely on the section's overall legislative purpose where the language and legislative history of a specific term indicated a contrary construction. However, the *Reliance* Court did note in dicta that if more than one construction of the term were possible, the term would be given the construction "that best serves the congressional purpose of curbing short-swing speculation by corporate insiders."[84] It can be inferred from this statement that the section's remedial purpose is not to be considered in initially construing the definitional term. Rather, as both *Blau* and *Reliance* indicate, only the language and legislative history of that specific term are to be considered in the initial construction. Only if those factors indicate that more than one construction of the term is possible will the section's remedial purpose be considered.

In *Kern County Land Co. v. Occidental Petroleum Corp.*,[85] the third case in the series, the Court for the first time interpreted a 16(b) def-

[77] 368 U.S. at 412. See note 119 *infra.*
[78] 404 U.S. 418 (1972).
[79] *Id.* at 424-25.
[80] *Id.* at 420.
[81] *Id.* at 423.
[82] *Id; see* 15 U.S.C. § 78p(b) (1970), *quoted at* note 11 *supra.*
[83] 404 U.S. at 424-25. See note 33 *supra.*
[84] 404 U.S. at 424.
[85] 411 U.S. 582 (1973).

initional term in a manner which took account of the susceptibility of the challenged transaction to insider abuse.[86] The Court was asked to find that either an exchange of stock pursuant to a merger agreement or the giving of an option to purchase shares was a "sale" within the meaning of 16(b).[87] The Court initially inquired into whether the transaction fell within the section's definition of a "sale."[88] The Court concluded that, in light of the definition Congress gave the term in section 3(a)(14) of the Act,[89] it was broad enough to reach "many transactions not ordinarily deemed a sale."[90] Having determined that the term was susceptible to alternative constructions, the Court then proceeded to examine whether the transactions were the type which could lead to an abuse of inside information.[91] Since the inquiry did not indicate a possibility of abuse, the Court held that application of the section to the questioned transactions would not serve its remedial purpose.[92] Thus, for the first time, the Court considered a transaction in light of the section's general purpose. This second step in the Court's analysis was barred in *Blau* and *Reliance* because the language and legislative history of the definitional terms involved in those cases indicated only one possible construction, which construction put the transactions beyond the section's reach. In *Kern,* however, the language and legislative history of the term "sale" indicated possible alternative constructions. Therefore, consistent with its dicta in *Reliance,*[93] the Court determined whether the section's purpose would best be served by imposing liability.

In all fairness to the *Whiting* court, however, it should be noted that this interpretation of the *Blau, Reliance,* and *Kern County* decisions was not apparent until the Court's post-*Whiting* decision in *Foremost-McKesson, Inc. v. Provident Securities Co.*[94] which elucidated the approach of the earlier decisions. In *Provident,* the Court followed the approach it had suggested in the three previous 16(b) cases. *Provident* posed the question of whether a single purchase and subsequent sale of more than 10 percent of a company's stock fell within 16(b).[95] In resolving this issue, the Court focused on the 16(b) exemptive provision[96] which states that 16(b) "shall not be construed to cover any transaction where such beneficial owner [10 percent shareholder] was not such both at the time of the purchase and sale . . . ."[97] An analysis

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[86] *Id.* at 596-604.

[87] *Id.* at 595-96.

[88] *Id.* at 593-94.

[89] 15 U.S.C. § 78c(a)(14) (1970) provides that "[t]he terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

[90] 411 U.S. at 594.

[91] *Id.* at 596-604.

[92] *Id.* at 597-98, 600, 601.

[93] 404 U.S. at 424. See text at note 84 *supra.*

[94] 423 U.S. 232 (1976).

[95] *Id.* at 235.

[96] *Id.* at 245-56.

[97] 15 U.S.C. § 78p(b) (1970), *quoted at* note 11 *supra.*

of the legislative history and language of this provision indicated to the Court that it could not be construed to encompass the questioned transaction, since Congress intended that beneficial owners be liable only for profits on purchase-sale sequences made subsequent to becoming a beneficial owner.[98] Having reached this conclusion, the Court ended its analysis. Thus, the Court indicated, as it had in the previous 16(b) cases, that any consideration of the construction which best serves the congressional purpose is appropriate only if alternative constructions of the definitional term are available.[99] Since alternative constructions of the exemptive provision were not possible, the susceptibility to abuse analysis in which the *Kern* Court had engaged was inappropriate.

These four Supreme Court decisions indicate that the Court has not adopted the traditional pragmatic approach to 16(b) followed in *Whiting*. Rather than initially construing the section's terms in light of their particular legislative history, as the Supreme Court has, the *Whiting* court ignored the legislative history of "beneficial owner" and focused solely on the section's general remedial goal.[100] In light of the Supreme Court's emphasis on the legislative history of definitional terms, it appears that the viability of the result in *Whiting*, as well as other cases which have attributed a spouse's transactions to a director, rests squarely on whether an analysis of the legislative history will support a broad reading of "beneficial owner."

The Securities Exchange Act of 1934[101] was Congress' response to evidence adduced in congressional hearings[102] which demonstrated that uncontrolled market speculation and manipulation, faulty credit control, investor ignorance and abuses of fiduciary relationships played a significant role in the 1929 stock market crash and subsequent depression.[103] Section 16[104] of the Act was designed to protect the investing public by preventing directors, officers and large shareholders from abusing their fiduciary relationships by speculating on the basis of inside information.[105]

In 16(a),[106] the reporting section, Congress sought both to encourage private maintenance of fiduciary standards and to inform investors of an insider's private opinion of the company's prospects by

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[98] 423 U.S. at 249.

[99] *See id.* at 244.

[100] 523 F.2d at 688.

[101] Act of June 6, 1934, ch. 404, § 1, 48 Stat. 881, *as amended*, 15 U.S.C. § 78 (1970).

[102] *See generally* SENATE COMM. ON BANKING AND CURRENCY, STOCK EXCHANGE PRACTICES, S. REP. NO. 1455, 73d Cong., 2d Sess. (1934).

[103] H.R. REP. NO. 1383, 73d Cong., 2d Sess. 6 (1934); S. REP. NO. 792, 73d Cong., 2d Sess. 3 (1934).

[104] 15 U.S.C. § 78p (1970).

[105] H.R. REP. NO. 1383, 73d Cong., 2d Sess. 13 (1934); S. REP. NO. 792, 73d Cong., 2d Sess. 9 (1934).

[106] 15 U.S.C. § 78p(a) (1970). See note 46 *supra*.

publicizing any changes in an insider's beneficial ownership.[107] Indeed, the House Report described this section as "the most potent weapon against the abuse of inside information . . . ."[108] A broad construction of "beneficial owner" in section 16(a) is consistent both with this purpose and the general language of the section. Unlike 16(b), which focuses on sales and purchases within a six month period,[109] 16(a)'s primary emphasis is on reporting *any* change in beneficial ownership.[110] Thus, the 16(a) reports may reveal not only 16(b) violations but also violations of sections 9[111] and 10[112] of the Act.[113] Moreover, the term "beneficial owner" itself apparently was designed to be broad in the context of section 16(a). In his testimony before the Senate Banking and Currency Committee, Mr. Thomas Corcoran, a drafter of the Act, stated that "beneficial owner" was the "broadest term you can have."[114]

This legislative history and language indicates that the SEC's broad construction of "beneficial owner" in 16(a) is appropriate.[115] This broad interpretation of 16(a) does not, however, provide a basis for infusing "beneficial owner" in 16(b) with the SEC's interpretation of that term in 16(a), as the court did in *Whiting*.[116] Indeed, the SEC, recognizing a distinction between 16(a) and 16(b), has stated that its reporting requirement is not necessarily coextensive with 16(b) liability.[117]

The legislative history of spousal attribution under 16(b) does not provide a basis for the broad interpretation of "beneficial owner" within the meaning of that section. Three provisions in the Senate's draft of the Act bear directly on the question of whether a spouse's transactions can be imputed to a director for 16(b) purposes.[118] Section 15(b), the forerunner of section 16(b), contained a provision which enabled an issuer to recover short-swing profits made by

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[107] H.R. REP. NO. 1383, 73d Cong., 2d Sess. 13, 24 (1934).

[108] *Id.*

[109] See note 11 *supra*.

[110] See note 46 *supra*. *See* Feldman & Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 WEST. RES. L. REV. 1054, 1063 (1966).

[111] 15 U.S.C. § 78i (1970). This section regulates manipulation of security prices.

[112] *Id.* § 78j. This section regulates short sales and the use of manipulative and deceptive devices in connection with the purchase or sale of a security. Short sales are sales "accomplished by selling securities which the seller does not own. Securities are borrowed for sale with the expectation that the price of the security will decline and a profit made by repaying the borrowed securities with securities acquired at the lower price." Feldman & Teberg, *supra* note 110, at 1062 n.41.

[113] Feldman & Teberg, *supra* note 110, at 1063.

[114] *Hearings on Stock Exchange Practices Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess., pt. 15, at 6556 (1934) [hereinafter cited as *Stock Exchange Hearings*].

[115] See text at notes 47-49 *supra*.

[116] 523 F.2d at 688.

[117] 31 Fed. Reg. 3175, 3176 (1966).

[118] These provisions were also in the House draft. *Compare* S. 2693, 73d Cong., 2d Sess. §§ 15(b)(3), 19(b), 19(d) (1934), *with* H.R. 7852, 73d Cong., 2d Sess. §§ 15(b)(3), 19(b), 19(d) (1934).

tippees.[119] Section 19(d) of the draft provided that if a spouse, or any one of several other enumerated individuals, engaged in a transaction which, if engaged in by an individual subject to any of the Act's provisions, would be a violation of the Act, the transaction would be imputed to that individual.[120] This subsection further provided that the individual would not be found in violation of the Act if he demonstrated that the transaction was effected neither with his approval nor for the purpose of evading the Act.[121] Finally, section 19(b) of the draft stated that acts of individuals controlled by persons subject to the Act were to be imputed to those persons.[122]

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[119] Section 15(b)(3) of S. 2693, 73d Cong., 2d Sess. (1934), provided that it was unlawful for an insider:

> To disclose, directly or indirectly, any confidential information regarding or affecting any such registered security not necessary or proper to be disclosed as a part of his corporate duties. Any profit made by any person, to whom such unlawful disclosure shall have been made, in respect of any transaction or transactions in such registered security within a period not exceeding six months after such disclosure shall inure to and be recoverable by the issuer unless such person shall have had no reasonable ground to believe that the disclosure was confidential or was made not in the performance of corporate duties. Such suit may be instituted in law or in equity in any court of competent jurisdiction by the issuer or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter. For the purposes of this subsection the profit shall be calculated on the sale or sales by such person of such security made at the highest price or prices and on the purchase or purchases made by such person of such security at the lowest price or prices during the six-months' period irrespective of the certificates for such security received or delivered to such person during such period.

*Id.*

[120] Section 19(d) of S. 2693, 73d Cong., 2d Sess. (1934) provided:

> If the spouse of a person subject to any provision of this Act or of any rule or regulation thereunder, or a child or parent residing with such person, or a person holding in trust for such person money or property used in the transaction in question shall effect any transaction in a security which would be a violation of any such provision if effected by such person subject thereto, such person subject thereto shall be deemed to have violated such provision unless he shall sustain the burden of showing that the transaction was not effected with his approval or was not for the purpose of evading such provision.

*Id.*

[121] *Id.*

[122] Section 19(b) of S. 2693, 73d Cong., 2d Sess. (1934) provided:

> It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this Act or any rule or regulation thereunder through or by means of any other person who is controlled by such person by or through stock ownership, agency, or otherwise or through or by means of any other person who is controlled by such person and one or more other persons by or through stock ownership, agency, or otherwise for the purpose of avoiding any provisions of this Act or any rule or regulation made thereunder.

*Id.*

Mr. Corcoran referred to these provisions during his 16(b) testimony:

> Senator Carey. Would it be possible for a man to have several people purchase . . . stock for him?
>
> Mr. Corcoran. There are provisions later to catch his wife and children, as well as trustees for him. There is also a provision in the next section to catch those whom he tips off, and who probably buy for his account, and split the profit, insofar as they can be caught. . . .[123]

This dialogue demonstrates that the drafters of the Act did not initially intend that a spouse's transactions be attributed to a director under 16(b) alone. Rather than being exposed to automatic liability,[124] a director, under the proposed spousal attribution provision, was to be given an opportunity to demonstrate that he neither gave his approval to his spouse's transactions nor intended to evade the Act.[125] Moreover, if a director made an unlawful disclosure of confidential information to his spouse, the spouse, and not the director, would be held liable under the tippee provision for the profit.[126] However, if it could be established that a director actually or legally controlled his spouse's transactions,[127] section 19(b) would allow those transactions to be imputed to him for purposes of establishing 16(b) liability.[128]

The controlled person provision—section 19(b)—was retained in the final legislation.[129] Thus, there is a sound legislative basis for at-

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[123] *Stock Exchange Hearings, supra* note 114, 6558.

[124] Section 16(b) liability is imposed irrespective of the insider's intent. See note 33 *supra*.

[125] See note 120 *supra*. In his testimony, Corcoran stated that this section in effect provides that "if the wife of a director sells short the stock of her husband's company . . . he has the burden of proof that the transaction was not done with his approval, nor for the purpose of enabling him to evade the prohibition against his selling stock short." *Stock Exchange Hearings, supra* note 114, at 6571.

[126] See note 119 *supra*.

[127] The presence of §§ 19(b) and (d) in the same draft suggests that 19(b) referred to either actual or legally enforceable control and not control by means of a family relationship. Indeed, the final House Report stated that control includes actual as well as "legally enforceable control." H.R. REP. NO. 1383, 73d Cong., 2d Sess. 26 (1934).

[128] See note 122 *supra*.

[129] 15 U.S.C. § 78t(b) (1970). This section provides that "[i]t shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person." *Id.* Subsection (b) differs from subsection (a), 15 U.S.C. § 78t(a) (1970), discussed at note 75 *supra*, which applies to persons *controlling* an individual subject to the Act. Subsection (b) imputes to an *individual subject to the Act* transactions by individuals whom he *controls*. Moreover, unlike subsection (a), this subsection provides neither a good faith nor a "did not induce" defense. Nevertheless, it appears that before subsection (b) can be invoked there must be evidence that the insider knowingly used the controlled person. *See* SEC v. Coffey, 493 F.2d 1304, 1318 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975). The purpose of these two provisions is to prevent evasion of the Act through surrogates. *Stock Exchange Hearings, supra* note 114, at 6571. Unlike the earlier drafts, however, the section as enacted does not have examples of control because Congress thought it difficult, if not impossi-

tributing a spouse's transaction to a director if it is established that the spouse is the director's alter ego. However, Mr. Whiting neither actually nor legally controlled Mrs. Whiting's investment decisions.[130] Indeed, the district court specifically found that "there is no evidence that he [Mr. Whiting] controls her [Mrs. Whiting's] decisions concerning even the general aspects of her management of her estate."[131] Therefore, only the tippee or the spousal attribution provisions in the early Senate drafts would have provided a basis for imputing Mrs. Whiting's sales to Mr. Whiting.

The 15(b) tippee provision was deleted from the final legislation, apparently because of anticipated problems in administration.[132] Section 19(d), which provided for spousal attribution, was also eliminated.[133] Although this latter provision was criticized during the Senate hearings,[134] the reasons for its exclusion are unclear. The provision created a rebuttable presumption that if any of the enumerated persons engaged in a transaction which an individual subject to the Act could not legally accomplish, that individual would be held liable.[135] Thus, the provision was in effect a broad amendment to every other provision of the Act. The thrust of the criticism appears to have centered on this far-reaching effect. One senator expressed concern that the provision might prevent a son who was living with his father from becoming a broker if his father were an underwriter or dealer.[136] One witness viewed the enumerated persons as independent and expressed concern that their inadvertent acts might cause criminal penalties to be imposed on an individual subject to the Act.[137] Moreover, the provision was specifically criticized for including wives in the list of persons whose actions could be imputed:

> [S]o far as wives are concerned, the provision is a departure from the principle of the married women's separate property acts and the whole course of legislation in favor of equal rights for women, which has been the distinguishing mark for the last quarter century.[138]

Although the criticisms of the 19(d) attribution provision do not clearly suggest the basis for its deletion, they do suggest that the provision was regarded as too far-reaching—either to the extent of apply-

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ble, to define the many ways in which actual control might be exerted. *See* H.R. REP. No. 1383, 73d Cong., 2d Sess. 26 (1934).

[130] *Whiting*, 523 F.2d at 685.

[131] 386 F. Supp. at 1132.

[132] *See Stock Exchange Hearings, supra* note 114, at 6560-61; *Blau*, 368 U.S. 403, 412 n.12 (1962).

[133] *Compare* S. 2693, 73d Cong., 2d Sess. § 19 (1934), *with* S. 3420, 73d Cong., 2d Sess. § 20 (1934).

[134] *Stock Exchange Hearings, supra* note 114, at 6572-73, 6639, 7022.

[135] See note 120 *supra*.

[136] *Stock Exchange Hearings, supra* note 114, at 6572-73 (remarks of Senator Kean).

[137] *Id.* at 6639.

[138] *Id.* at 7022.

ing to every provision of the Act or in the operation of the attribution concept itself. Thus, unless section 16(b) was modified after this provision was eliminated, it appears unlikely that when Congress deleted the provision it intended that the spousal attribution concept was to be incorporated into that section.

A comparison of the language of 16(b) before and after the deletion of the 19(d) spousal attribution provision indicates that 16(b) was not modified to impute a spouse's transactions to an insider. Section 19(d) did not provide for attribution if the insider could demonstrate that the transaction was not effected either with his approval or for the purpose of evading the Act.[139] At the time this section was deleted, 16(b) imposed absolute liability.[140] This liability standard was not modified after section 19(d) was deleted.[141] Thus, it appears that 19(d)'s defenses were not incorporated into 16(b). To read 16(b) as incorporating 19(d)'s spousal attribution concept would amount to a conclusion that 19(d) was rejected because it was too lenient. This is true because the liability would remain under 16(b) while the defense would be eliminated. As previously indicated, however, the criticisms of section 19(d) indicate that it was rejected because it was too harsh.

In addition, at the time of the deletion of the attribution provision, 16(b) provided that "[i]t shall be unlawful for any director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, . . ." to purchase and sell any security of the issuer within six months.[142] The final version of 16(b) states that "[f]or the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer" any profit realized on a short-swing trade shall inure to the issuer.[143] It appears that "such beneficial owner" was substituted in the final version for the original phrase "owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer." This language change indicates that "beneficial owner" was not intended to incorporate the attribution concept into 16(b).[144] Rather, the phrase "benefi-

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[139] See note 120 *supra.*

[140] See note 33 *supra.*

[141] *Compare* S. 2693, 73d Cong., 2d Sess. § 15(b)(1) (1934), *with* S. 3420, 73d Cong., 2d Sess. § 16(b) (1934); *cf. Reliance,* 404 U.S. 418, 425 (1972).

[142] S. 2693, 73d Cong., 2d Sess. § 15(b) (1934).

[143] 15 U.S.C. § 78p(b) (1970), *quoted* at note 11 *supra.*

[144] The phrase "director, officer, or owner of securities, owning as of record and/or beneficially more than 5 per centum" of any class of stock of any issuer was common to both §§ 15(a) and 15(b) of the Senate draft. *See* S. 2693, 73d Cong., 2d Sess. §§ 15(a), (b) (1934). In the final version of § 15(a) the phrase was changed to "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security . . . or who is a director or officer . . . ." 15 U.S.C. § 78p(a) (1970). The change in subsection (a) was designed to clarify an error in draftsmanship. As originally drafted, the "owning" phrase could have been construed so as to apply to directors and officers as well as shareholders. However, Corcoran clearly established in his testimony that the "owning" phrase applied only to share-

cial owner" is synonymous with the phrase "beneficial owner of more than 10 per centum of any [registered security]," as finally enacted in section 16(a).[145]

If the language changes were in fact intended to incorporate the attribution concept into 16(b), the language chosen does not clearly evidence that intent. As the Supreme Court in *Foremost-McKesson, Inc. v. Provident Securities Co.*[146] stated: "It is inappropriate to reach the harsh result of imposing § 16(b)'s liability without fault on the basis of unclear language."[147] Thus, it seems unlikely that the Court would interpret the changes in 16(b)'s language to encompass spousal attribution. It is submitted, therefore, that the legislative history of "beneficial owner" does not provide a basis for the *Whiting* court's broad construction of that term.[148] Rather, the legislative history suggests that

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holders. *See Stock Exchange Hearings, supra* note 114, at 6555. *See also Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate & Foreign Commerce*, 73d Cong., 2d Sess. 133 (1934). Since the original phrases were identical, it is not unlikely that the change in 15(b) was designed to achieve the same purpose.

[145] *See* 15 U.S.C. § 78p(a) (1970), *quoted at* note 46 *supra*. One additional change was made to 16(b) after the 19(d) attribution and 16(b) tippee provisions were deleted. A provision was added to both the Senate and House versions of 16(b) which stated that the subsection was not to be construed to cover transactions which the SEC by rules and regulations might exempt as not comprehended within the subsection's purpose. *See* S. 3420, 73d Cong., 2d Sess. § 16(b) (1934); H.R. 8720, 73d Cong., 2d Sess. § 15(b) (1934). This provision was retained in the final legislation. *See* 15 U.S.C. § 78p(b) (1970), *quoted at* note 11 *supra*. While giving the SEC exemptive power, however, Congress does not appear to have given the Commission the inclusive authority to attribute spousal transactions to 16(b) insiders. In contrast to § 10(b) of the Act, 15 U.S.C. § 78j(b) (1970), which grants the SEC broad power to make whatever rules and regulations are necessary or appropriate to achieve 10(b)'s purpose of preventing the use of manipulative and deceptive devices in connection with the purchase or sale of a security, *see id.*, § 16(b) grants only the power to exempt. Thus, while § 10(b) gives the SEC the power to specifically proscribe those activities which fall within its general prohibition, § 16(b) limits Commission power to excluding transactions from its specific proscriptions when those transactions involve no insider abuse. It thus appears that if Congress intended that the SEC exercise under § 16(b) the broad power to add to the list of congressionally proscribed transactions, the phraseology used to grant the rulemaking power would have been similar or identical to that used in § 10(b). Thus, the Commission has no power to incorporate spousal attribution into 16(b).

[146] 423 U.S. 232 (1976).

[147] *Id.* at 252.

[148] It also appears that the phrase "profit realized by him," 15 U.S.C. § 78p(b) (1970), on which the district court relied, see text at note 16 *supra*, cannot be construed to require the attribution of spousal transactions. The deleted spousal attribution provision originally was intended to encompass those transactions. See text at notes 120-22 *supra*. At the time of its deletion, the relevant section of 16(b) stated that "any profit made by such person [an insider] . . . shall inure to and be recoverable by the issuer." S. 2693, 73d Cong., 2d Sess. § 15(b)(1) (1934). As finally enacted, this phrase reads "profit realized by him." 15 U.S.C. § 78p(b) (1970). It appears that this change in phraseology did not expand the term's meaning to require spousal attribution. Rather, the term appears to be no more than a simple statement of the amount of damages recoverable by the issuer. *See* Smolowe v. Delendo Corp., 136 F.2d 231, 237-39 (2d Cir. 1943).

the term is to be narrowly construed to mean only a 10 percent shareholder.[149]

While the legislative history of section 16(b) militates against imputing spousal transactions to an insider, the *Whiting* court's conclusion that the policy goals of the 1934 Act would be thwarted absent attribution is understandable. The underlying assumption of 16(b) is that unless absolute liability is imposed on short-swing trading by insiders, the Act's goal of maintaining free and honest markets will be threatened by insiders exploiting their access to nonpublic corporate information to reap personal benefit.[150] If 16(b) is construed to exclude spousal attribution where there is no evidence of actual insider control of the spouse's transactions, it appears that the Act's goal may be thwarted. As the *Whiting* district court so accurately observed, "the usual family unit shares the prosperity and the adversity of its members, and communicates concerning matters of common concern."[151] Thus, the possibility exists, as both the *Whiting* district and circuit courts recognized,[152] that if an insider shares in the economic benefits of his spouse's ownership, he might communicate inside information to his spouse who will then trade on the basis of that information. Therefore, the overriding policy of 16(b) and the nature of the familial relationship provide strong support for spousal attribution.

Indeed, it may be contended solely on the basis of policy, that the *Whiting* courts did not go far enough. The "economic benefits" test fails to recognize that the possibility of insider abuse exists in every spousal relationship. "[C]ommon financial interests . . . exist irrespective of the precise use of the proceeds . . . " of a spouse's securities.[153] For example, if an insider knew that failure to communicate confidential information to his spouse would result in severe losses, it appears likely that his concern for his spouse's financial well-being would lead him to ignore his fiduciary obligations.[154] Moreover, the possibility of such abuse would be even greater if his spouse's investments were to be used to meet a moral or social obligation to adult children or aging parents[155] or if the insider knew that he might inherit his spouse's investments. Likewise, the mere knowledge that his spouse's investments are available to cushion his personal economic disasters creates a possibility of abuse of inside information. It seems likely, therefore, that an insider would be tempted to com-

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[149] *See* Foremost-McKesson, Inc, Inc. v. Provident Sec. Co., 423 U.S. at 249-50. The Court in *Provident* also interpreted "such beneficial owner" in § 16(b)'s exemptive provision as applying only to 10% shareholders and not directors or officers. *Id.* at 245.

[150] *See Provident*, 423 U.S. 232, 243-44 (1976); *Kern*, 411 U.S. 582, 591-92 (1973); *Reliance*, 404 U.S. 418, 422 (1972).

[151] 386 F. Supp. at 1137.

[152] 523 F.2d at 688-89; 386 F. Supp. at 1136-37.

[153] Feldman & Teberg, *supra* note 110, at 1069.

[154] *See* Shreve, *Beneficial Ownership of Securities Held by Family Members*, 22 BUS. LAW. 431, 434 (1967).

[155] *See* Feldman & Teberg, *supra* note 110, at 1069.

municate inside information to a spouse whether or not the insider currently shares in the economic benefits of ownership. Thus, if the legislative history of "beneficial owner" could be ignored and the Act's goal of free and fair markets were the sole consideration, all spousal transactions would be attributed to an insider for 16(b) purposes.

Under the analytical framework designed by the Supreme Court, however, this legislative history cannot be ignored. The legislative history of both the "beneficial owner" and the "profit realized by him" provisions indicates that spousal attribution should not be used to create 16(b) liability in the absence of evidence demonstrating that the spouse is the director's alter ego. This interpretation is subject to the criticism that it will allow escape in situations where there is a great likelihood of insider abuse. However, in light of the catch-all sanctions of Rule 10b-5,[156] the escape may be illusory.

Although the Supreme Court in *Provident* stated that 16(b)'s scope is not affected by whether alternative sanctions might prevent insider abuse,[157] the Court concurrently recognized that Congress has left some problems of insider abuse to other remedies, thereby "alleviat[ing] concern that ordinary investors are unprotected against actual abuses of inside information in transactions not covered by § 16(b)."[158] Indeed, the Court noted that section 10(b) and Rule 10b-5 might provide a basis for redressing the abuses which Foremost had argued would ensue from a broad interpretation of 16(b)'s exemptive provision.[159] Thus, it can be inferred from the Court's statements in *Provident* that while the *absence* of alternative sanctions will not provide a basis for spousal attribution under 16(b), where, as in the case of spousal attribution, the legislative history of 16(b) does not clearly establish liability, the *availability* of an alternative remedy will buttress the conclusion that Congress left that particular problem of insider abuse to other sanctions.

The availability of Rule 10b-5 to redress spousal abuse of inside information suggests that the escape created by failing to include spousal transactions under 16(b) is more apparent than real. If an insider communicated nonpublic corporate information to his spouse, he would be considered a "tipper" and his spouse a "tippee" for pur-

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[156] 17 C.F.R. § 240.10b-5 (1975). This Rule provides:

> It shall be unlawful for any person . . .
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

*Id.*

[157] 423 U.S. at 255.

[158] *Id.*

[159] *Id.* at 255 n.29.

poses of Rule 10b-5. Tippees who have traded on the basis of information not generally known have been held subject to the Rule's sanctions.[160] Moreover, insiders who have communicated material[161] nonpublic information to tippees have also been found liable under the Rule.[162] To hold a tippee and a tipper subject to the sanctions of Rule 10b-5, it must be established that the communication occurred and that the recipient had reason to know that the information received was material and nonpublic.[163] Whether a tippee has reason to know that the information received is material and nonpublic can be inferred from the circumstances.[164] Likewise, the communication itself can be inferred.[165]

The most significant difference between section 16(b) and Rule 10b-5 is the burden of proof necessary to establish the respective violations. Section 16(b) imposes absolute liability without regard to proof of actual abuse or intent.[166] Rule 10b-5, on the other hand, requires proof of actual use or abuse of inside information.[167] Inasmuch as the deleted spousal attribution provision did not impose absolute liability, it would not seem unreasonable to impose the Rule's proof requirements on spousal transactions.

It is submitted that under the proof of abuse standard, Mr. Whiting as a tipper, and Mrs. Whiting as a tippee, might have been held liable under Rule 10b-5, if material information was communicated. The type of financial relationship which the Whitings had established would be strong circumstantial evidence that Mr. Whiting communicated information to his wife which she knew was material and nonpublic.[168] Thus, the very type of relationship which the

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[160] *See, e.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974); *In re* Investors Management Co., [1970-71 Transfer Binder] CCH FED. SEC. L. REP. ¶78,163 (SEC 1971); *cf.* SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262 (S.D.N.Y. 1966), *aff'd in part, rev'd in part*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

[161] The Second Circuit in SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969), defined material information as facts which affect the desire of an investor to buy, sell or hold. 401 F.2d at 849.

[162] *See, e.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); Financial Indus. Fund, Inc. v. McDonnell Douglas Corp. [1970-71 Transfer Binder], CCH FED. SEC. L. REP. ¶93,004 (D. Colo. 1971).

[163] *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237-38 (2d Cir. 1974).

[164] *See In re* Investors Management Co., [1970-71 Transfer Binder] CCH FED. SEC. L. REP. ¶78,163, at 80,520-22 (SEC 1971).

[165] *See* Ross v. Licht, 263 F. Supp. 395, 405, 409-10 (S.D.N.Y. 1967); SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 284 (S.D.N.Y. 1966), *aff'd in part, rev'd in part*, 401 F.2d 833, 852 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

[166] See notes 11 & 33 *supra*.

[167] *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 235-36 (2d Cir. 1974).

[168] *See* Ross v. Licht, 263 F. Supp. 395 (S.D.N.Y. 1967). In *Ross*, the court imposed Rule 10b-5 sanctions on three dentists for trading either as insiders or tippees. The court based its decision on an analyais of the dentists' relationship to the corpora-

*Whiting* court used to impose 16(b) liability on Mr. Whiting could also be the basis for imposing Rule 10b-5 liability on either or both of the Whitings.[169]

## CONCLUSION

Although the *Whiting* decision may effectuate section 16(b)'s congressionally declared purpose of preventing the unfair use of inside information, the Supreme Court has indicated that this policy is to be considered only if alternative constructions of the section are possible. Whether alternative constructions are possible is to be determined by the language and legislative history of the definitional term which brings the transaction within the section's proscriptive boundaries. The language and legislative history of "beneficial owner" in section 16(b) militate against the Second Circuit's broad interpretation of that term. In light of the Supreme Court's seemingly narrow approach to construing the section's definitional terms, it appears that the Second Circuit has incorrectly imposed 16(b)'s harsh proscription. Congress did not intend to incorporate into 16(b) spousal attribution in the absence of evidence that the director controls his spouse's transactions. Moreover, the availability of Rule 10b-5 will prevent frustration of the Act's general goals in those situations where abuse actually occurs.

ANN E. WEIGEL

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tion. One of the dentists was a member of the family which controlled the corporation and was in close touch with his brothers who ran the corporation. The other two dentists were long-standing, close friends of the insider brothers. Moreover, the three dentists were friends and had combined to loan money to the corporation in the past. These facts suggested to the court that all three had access to inside information which should not be used for personal benefit. *Id.* at 409-10. Like the three dentists in *Ross*, Mrs. Whiting has a close, if not closer relationship, to an insider, her husband. The nature of this relationship when combined with Mr. Whiting's relationship to the corporation could thus support an inference of actual communication as well as abuse of inside information.

[169] While an issuer could not recover under Rule 10b-5 unless he was a purchaser or seller, *see* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 749 (1975), he might be able to recover under state law. *See, e.g.*, Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969); *cf.* Jones v. H.F. Ahmanson & Co., 1 Cal.3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969). The Court of Appeals of New York, for example, has held that the use of inside information by corporate officers or directors to obtain trading profits is a breach of their fiduciary duty which entitles the corporate shareholders to recover on behalf of the corporation. Diamond v. Oreamuno, 24 N.Y.2d at 501, 248 N.E.2d at 914, 301 N.Y.S.2d at 84. If the insider or his spouse feared liability at both the state and federal levels, the proper course of action would be to interplead in the initial action all possible claimants. *See id.* at 504, 248 N.E.2d at 915, 301 N.Y.S.2d at 86.